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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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THE MARKET Probably no field of human endeavor is more difficult or tenuous than that of economic forecasting. As President Eisenhower learned in 1960, today's business prediction may well be tomorrow's bad joke. This does not stop our new Secretary of the Treasury, however, and only last week Mr. Dillon ventured to predict: "It is probable that by this time next year our economy will be rolling in high gear. We may well be in the midst of an economic boom." Mr. Dillon went even further; he made so bold as to spend some of the money which is going to be "left over" after tax collections in booming 1962-63. According to the June 21 Wall Street Journal, Mr. Dillon announced: "It's not been decided whether this surplus will be used to pay off part of the Federal debt or used for a tax refund. But he added, a tax reduction 'would probably be the course of events to expect'."

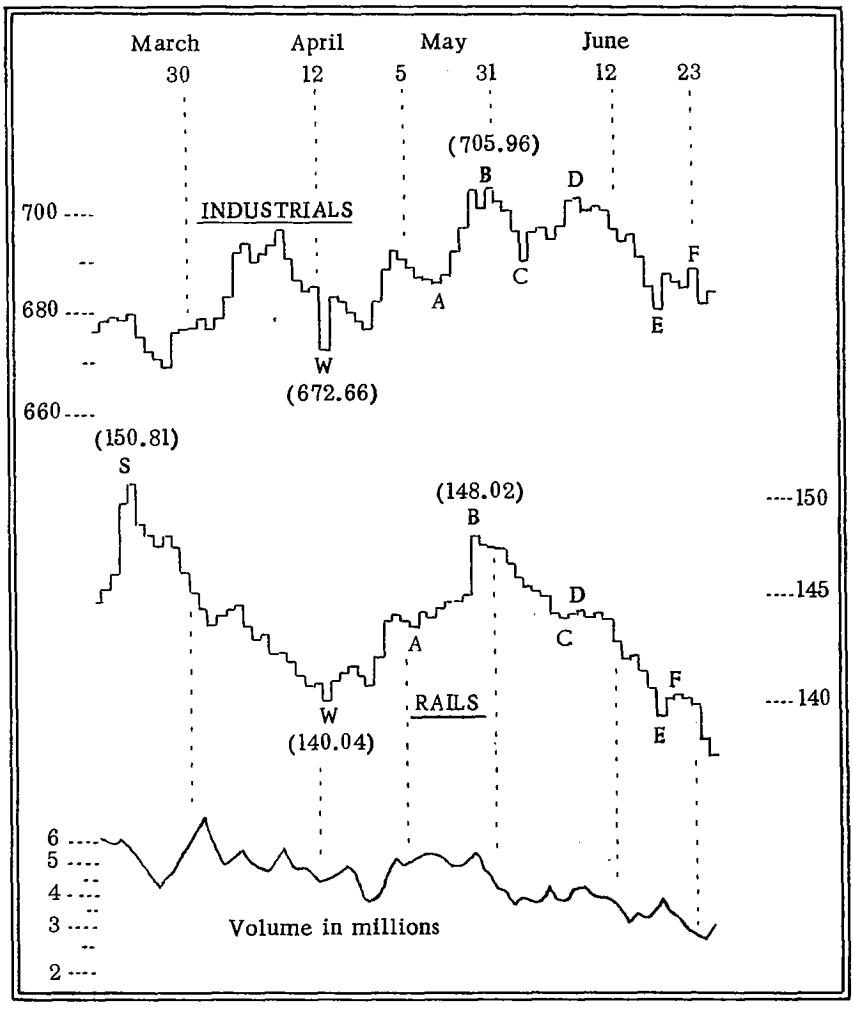
Fortunately, market students have something more reliable than Mr. Dillon's predictions to hang their "investment hats" on. We have the Averages, a pair of indicators which have a long history of correctly adjusting to facts, fancies, hopes, correct appraisals and the "forecasts" of Governmental leaders.

This writer claims to know no more than what he can deduce from the action of the market. For many months now the market has been saying that times were going to get better, and indeed, they have gotten better (at least better than they were last year). When the primary trend is up, then regardless of our own theories or notions, it is best to keep our thinking on the "constructive" side. Nevertheless, every movement reaches an eventual peak, and the stock market reserves the right to "change its mind" at any time -- without fanfare or warning.

From the bullish standpoint, the "fly in the ointment" has been and still is the poor performance of the Rail Average. On June 9 (see Letter 147) Rails violated their preceding decline low at A. On June 16 Industrials confirmed by breaking their own low point at A. Letter 147 took note of this and further commented on the fact that for the first time since October, 1960, both Averages had violated preceding decline points.

On June 19 (E on chart) Rails sagged to 139.40, thereby violating the entire Rail structure which has been built since January of this year. Under Dow Theory, however, the action of the two Averages must always be considered together. For this reason, the case for a strong or weak market now falls squarely upon the Industrial Average.

For over two weeks volume has remained dull on advances and declines, thus affording few clues as to impending buying or selling pressure. Rails have retreated steadily. On June 23 Industrials rallied while Rails diverged. On June 26 Industrials dropped to within a fraction of their June 19 low (at E), and Rails declined again. June 27 saw a strange mixture -- Industrials rose 2.72 points, Rails diverged (sinking to another new low of 137.75), and the advance-decline ratio touched its lowest level of



the entire decline. The ability of the Industrial Average to hold above points E (680. 68) and W (672. 66) will provide the first clues as to the near-term direction of the market.

CONCLUSION: The primary trend remains bullish. The secondary trend probably turned bearish when Industrials violated point A (686. 49). An Industrial penetration of point W (672. 66) would provide conclusive proof that the secondary trend has turned down.

The market is now at an extremely interesting juncture. Because (1) the advance-decline ratio has sustained such severe damage, (2) because the Rail Average has traced declining tops (points S and B) and has now retreated to the levels of early January, (3) and because volume and the new high index have contracted with each rally, I am of the opinion that any rise from here will probably be confined to the leading stocks in the D-J Industrial Average.

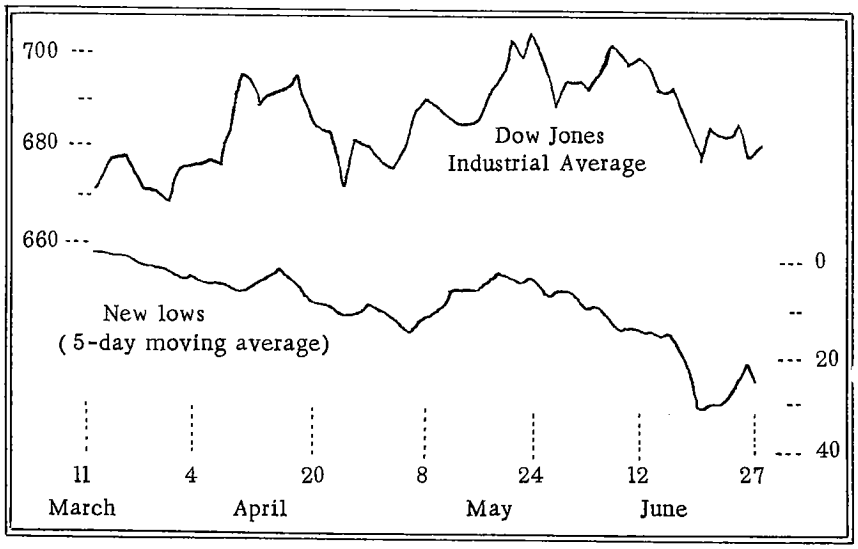
If the Industrial Average now rallies to or above its recent high of 705. 96, and if the aforementioned market characteristics persist (i. e. , poor breadth, sluggish Rail Average, lagging volume and an unimpressive list of new highs) it would pay readers to be on their guard. I will go even further and say that any forthcoming rally in the D-J Industrial Average which is accompanied by the previously discussed elements of weakness should be considered as a general selling opportunity. Conversely, if, on the next rally, advances consistently outnumber declines, new highs expand, volume increases and the Rails get "in gear" on the upside (in other words, if the entire recent character of the market changes), stocks may yet live up to their "advance billings".

PERSPECTIVE When the Averages or the technical indicators turn down, one never knows whether the top has been seen or whether a new surge will produce new highs in a few or all of the indicators. In other words, major tops are generally recognized after the event. With these thoughts in mind, subscribers should realize that the Rail Average recorded its peak in March, the Industrial Average and Barron's Low-Priced Stock Index recorded their highs in May, volume hit its high in March, the advance-decline ratio touched its peak in May, the odd-lot ratio (10-day moving average) showed its heaviest rate of selling in May, the total short interest struck a high in December, 1960, and the short interest ratio established its peak in November, 1960. On the basis of the foregoing (and while realizing that the market may well go higher), I continue to believe that positions in stocks should be viewed as speculations (not investments).

NEW LOWS In Letter 146 I wrote: "One of the indications of a powerful advance is an expanding number of new highs. Conversely, a sign of technical weakness during a decline is a steadily increasing number of new lows." The rationale for this is simple -- an expanding number of new highs implies that an increasing number of individual stocks are "breaking out" of their established patterns. When a stock "breaks" to the upside (and this also applies to the Averages) the implication is that the move has further to go. The exact converse, of course, is true of downside penetrations (new lows) in individual stocks.

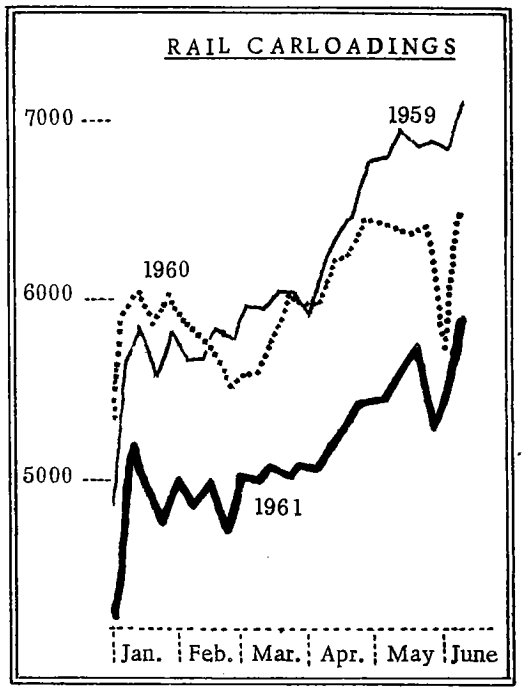
The steady contraction in the five-day moving average of new highs (see Letter 146) preceded the recent period of general market weakness. With the two Averages now well under their highs and with the advance-decline ratio (which is representative of all the stocks on the "Board") now at its early February level, our attention should also focus on the five-day moving average of new lows.

As seen on the chart, the new low index (inverted) has tended to expand over the last four months. Obviously, the number of new highs and lows bears a close relationship to the advance-decline ratio (or the level of the entire market). Thus, the late April weakness, which took the Industrial Average to 672, brought out an average of only 17 new lows (see chart). But the more recent mid-June weakness, which took the Industrial Average to 680 (while the advance-decline ratio dropped to the February levels), brought out an average of 32 new lows -- almost twice as many as before. CONCLUSION: During any further weakness, if the five-day moving average of new lows exceeds 32, I would take such action as a confirmation of deteriorating "breadth" (advance-decline ratio) and a definite warning signal.



CARLOADINGS Although "dyed-in-the-wool" market technicians prefer not to be bothered with fundamental facts, I believe that it is helpful to try to understand what the market is saying. The accompanying chart, as in the case of all pictures

is worth a thousand words. Here we see raw carloading figures (not adjusted for seasonal trend) for the January to mid-June periods of 1959, 1960 and 1961. This chart deals with the past, not the future, but it suggests that the Rail Average has been telling an accurate story. While production of goods this year has been satisfactory, transportation of goods (and probably sales) have been lagging.



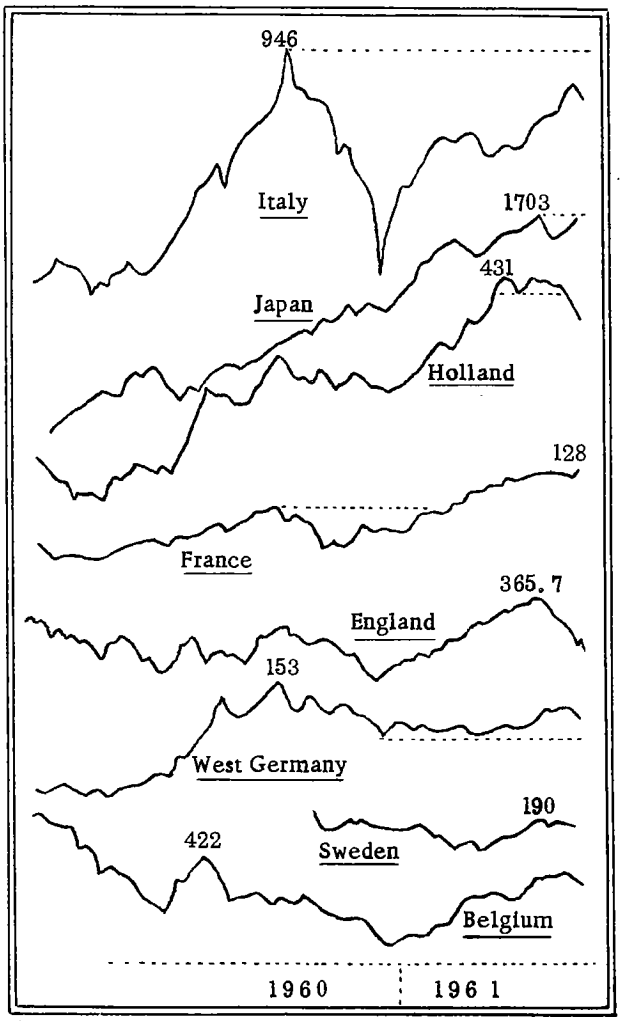
FOREIGN MARKETS Throughout history all primary and most important secondary stock movements have been international in scope. For this reason I feel that it is worthwhile to include periodic reviews of the price movements in the free world's major markets. As seen on the chart, the foreign markets now appear somewhat more hesitant than they did when last reviewed (Letter 140 - April 16). Four of the eight indexes are now tracing what must be considered secondary reactions.

Japan's "people's market" touched an all-time high of 1703 on May 17 (only two days before the 705.96 peak recorded by our own D-J Industrial Average). The Japanese average subsequently dropped into the high 1500's and since then has slowly worked back under the high.

Holland has traced a downward zig-zag of secondary proportions, and the Dutch market has now retreated to the February levels.

France's average has been in a long "line"; last week the line was broken to the upside, following which the French average rose to a new high.

Strangely enough, West Germany (with the free world's strongest economy) showed a market peak in August, 1960. The movements since then might be taken as part of an extended secondary reaction. A penetration of the December low would be considered ominously bearish.



Sweden's and Belgium's stock averages are under their 1960 highs, but both have been in the process of gradual recovery.

The London Financial Time's Average touched an extreme low of 295.2 in late 1960. During the following six months the British market rose to a May 15, 1961 peak of 365.7. A severe decline beginning in mid-May wiped out better than 65% of all the 1960-61 gains (the recent June 27 low was 319.4). Thus the English have the distinction of providing the poorest performance to be seen in any of the world markets this year.

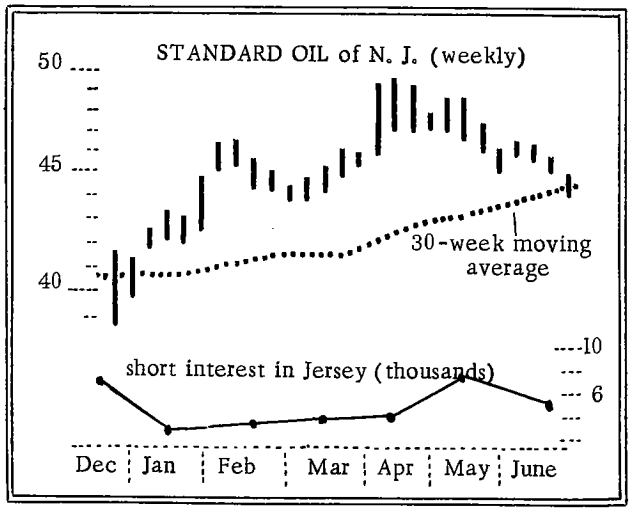
Italy's market staged a remarkable recovery from the "crash" of 1960. It will be important to see whether the Italian average can now better its 1960 high of 946.20.

STOCKS I am adding United Aircraft and Swift to our list of 15 (now 17) leading Dow stocks for continuing study. Of the 17 stocks, 8 have now dropped under their 30-week moving average, and appear bearish. This week, Standard of Jersey (see below), Swift (M.A. 45 1/2), and General Motors (M.A. 44 5/8) are added to last week's list of leaders which are now selling under their average price (M.A.) of the last 7 months or 30 weeks. This is the weakest showing yet.

Standard of Jersey (J) As seen on the chart, J rose above its M.A. in December, rallied to a high of 49 3/4 in April, 1961, and has been drifting lower ever since. Last week J finally broke under its M.A. (which is now 44 5/8. I would avoid J for investment or speculative purposes.

International Paper has broken down completely, having dropped under its M. A. (32 3/4) a few weeks ago. DuPont is one of the stronger looking Dow stocks, holding well above its M. A. of 205 and seeming to lead every rally in the market. DD has formed a rounding bottom and is trying to work higher. General Motors is one of the statistically "cheaper" Dow stocks, but this does not seem to impress investors. G. M. last week dropped under its M. A. of 44 5/8. Southern Pacific has been one of the "better rail stocks and has doggedly held above its M. A. which is now 22 1/2. Short position in Southern Pacific has dropped to the lowest level of the last 8 months.

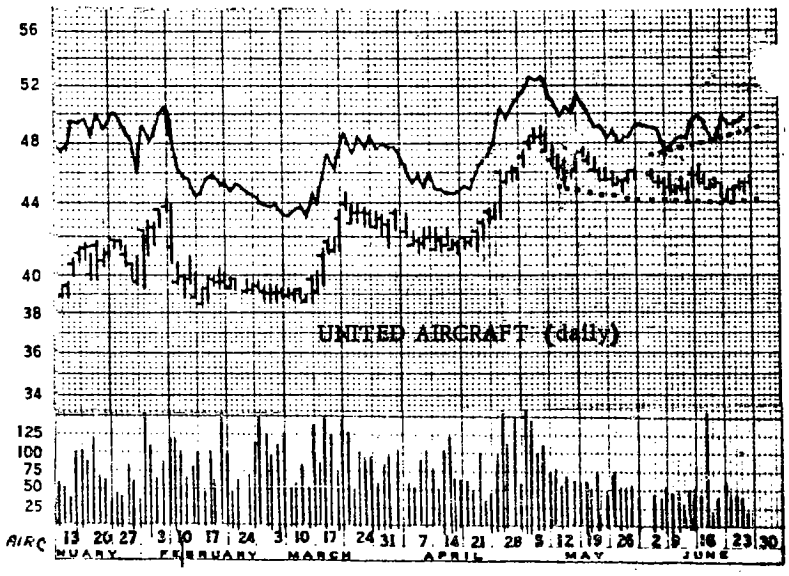
I have included a weekly chart of Republic Steel. From the huge "head-and-shoulders" distribution formation of 1958-59, RS plunged to a low of 48 1/2 in 1960. A powerful rally began in December, 1960, and it is interesting to see where the stock ran into trouble. The dotted line (65-66) represents the "support level" of 1958-59, above which RS was distributed. On the recent recovery, RS faltered at the 65-66 level as stock was again "fed out". Having failed to better the old "support level" (which is now resistance), RS broke sharply to the mid-50"s.



One of the few important stocks which has resisted decline since mid-May is United Aircraft (UR). This means that its relative strength (compared with the general market) has been excellent. The heavy black line above the daily price-movement on the chart of UR shows this improving relative strength, and the daily movements and volume suggest quiet accumulation. UR has held well above its M. A. (41 7/8) during the recent decline, and the stock represents an intelligent speculation in the 44-45 area. Stop-losses should be placed at 43. UR sold above 68 at its bull market top in late 1958.

(Charts of United Aircraft and Republic Steel courtesy of Traders Research, 6185 Lambert Airport, Missouri.)

(Written: June 28, 2 P. M.)



NOTE: Chart paper can be supplied to readers at a price of $1.00 per ten sheets, postpaid (first class) and packed flat. Size 8 1/2 x 11, punched for standard three-holed binders. Logarithmic or standard arithmetic scale paper available, and I particularly recommend the former for charting individual stocks. The logarithmic paper has logarithmic scale for volume, and the latter I also find valuable.

NOTE: For those interested in the Canadian market my friend, Mr. Iain Fraser, of 159 Bay Street, Toronto offers an excellent service covering the Canadian market. Of the 16 industries which he watches closely in Canada, he lists 15 as bullish and only one as bearish. There is absolutely no commission or any other arrangement between this writer and any organization or service mentioned in these Letters.